hardly examples of "varying holdings" or "currently lacking" uniformity, let alone an example of conflict with a decision of another United States Court of Appeals or with a decision of this Court as again required by Sup. Ct. R. 10 for this Court to issue a Writ of Certiorari.

As to the Petitioner's statement that there is a "split of the courts below", it begs the question of where? Again, there is no example given of a "split" amongst the United States Court of Appeals. The only possible "split" is contained within the sequence of decisions in this very case, *i.e.*, the Bankruptcy Court's granting of a partial summary judgment to the Petitioner, a reversal of that decision by the District Court and affirmation of the reversal by the Third Circuit. The Petitioner has not indicated division among the Courts of Appeals to resolve.

In short, the Petitioner's application is nothing more than an assertion that the lower court misapplied 11 U.S.C. § 506(b), which *supposed* misapplication of a properly stated rule of law, is not a basis to grant a petition for writ of certiorari. Sup. Ct. R. 10.

## II. The District Court and the Third Circuit correctly held that under Section 506(b), property is property in which the debtor's estate has an interest and does not include property that the debtor's estate has no interest.

The core of the Petitioner's argument is that 11 U.S.C. § 506(b) should be read in isolation of 11 U.S.C. § 506(a), to reach the Petitioner's conclusion that *all property* which secures a loan, regardless of whether the debtor has an interest in such property, should be examined in determining whether or not interest runs post-petition.

The problem with the Petitioner's argument is that it runs afoul with the logical progression in 11 U.S.C. § 506, of first (a) and then (b), to wit; if not secured no interest, if no interest then only principal and payments must be applied thereto accordingly. Further, the Petitioner's argument fails to consider the definition of property of the estate found at 11 U.S.C. § 541(a)(1) that property of the estate is comprised of "all legal or equitable interests **of the debtor** in property as of the commencement of the case." (emphasis added).

A post-petition interest analysis begins with what is the "claim", *i.e.*, the amount the DeNofas owed the Petitioner's predecessor, Continental Illinois, "at the date of the filing of the petition." 11 U.S.C. § 502(b).

Then, the claim, if allowed, is fixed at that amount. As set forth in Continental Illinois' proof of claim, the debt as of the date of filing of the DeNofas' petition was in the amount of $866,266.88, which thus comprised its claim in the DeNofas' case. The value of Continental Illinois' interest in the estate's interest in property of the estate was the value of the mortgage it held on the DeNofas' home which the District Court found to be $275,000.00. See Appendix D, page 18a, footnote 1. Continental Illinois simply held no other security in the DeNofas' estate's interest in property other than the DeNofas' home. Thus, in this case, as of the date of the DeNofas' bankruptcy filing, Continental Illinois held a secured claim in the amount of $275,000.00 and an unsecured claim in the amount of $591,266.88, a total of $866,266.88. This breakdown is the "plain meaning" of 11 U.S.C. § 506(a), to wit:

> An **allowed claim** of a creditor secured by a lien on property **in which the estate has an interest**, . . . is a secured claim to the extent of the

> value of such creditor's interest in the **estate's interest** in such property, . . . and is an unsecured claim to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim. (emphasis added).

Next, the analysis turns to 11 U.S.C. § 506(b) which states that if the "allowed secured **claim** is secured by property the value of which . . . is greater than the amount of such **claim**", the holder of the **claim**, is allowed to the extent of the oversecurity, interest, reasonable costs and charges as provided for under the agreement upon which such **claim** arose." (emphasis added).

It is clear from the entirety of the statutory language that in this case the DeNofas' home was the only property of the DeNofas' bankruptcy estate. That being so, as successor to Continental Illinois' undersecured claim, the Petitioner is entitled to no more than payment in full of its pre-petition claim. *Baybank Middlesex, supra*, at 1204.

The Petitioner contends that "Congress used the term 'property' in section 506(b) without limiting that term" and the "Third Circuit's construction of section of 506(b) imposes a limitation . . . [to] 'property in which the estate had an interest', in violation of the statute". See Petition, page 7. The Petitioner's argument rests upon cases cited for the general proposition that "statutory interpretation is that where a statute is plain and unambiguous on its face, a court must apply the statute as drafted." See Petition, page 8. Further, the Petitioner contends that the Third Circuit in considering the language of Section 506(b) "engaged in a forbidden interpretative analysis. By looking to the language of Section 506(a)", which the Petitioner contends is a "distinct" subsection and should not be

looked upon for "interpretation of Section 506(b)". See Petition, pages 9 and 10.

What the Petitioner fails to acknowledge is that the District and Third Circuit *did* apply 11 U.S.C. § 506 as drafted, not piecemeal as the Petitioner wants. Subsections 506(a) and 506(b) are part of the same statute – they are not and should not be read in isolation. Subsection (a) logically comes before subsection (b). Subsection (b) cannot be read without first reading subsection (a) to understand what is being stated in order to know whether to apply subsection (b). In this case, subsection (a) defines property as that which **"the estate has an interest"**, which definition is logically carried into subsection (b). (emphasis added).

Recently, this Court in *Rousey v. Jacoway*, 125 S.Ct. 1561, 161 L.Ed.2d 563, 73 USLW 4277 (2005), in coming to the meaning of a phrase in one part of the Bankruptcy Code, looked to other parts of the Bankruptcy Code to come to the meaning, to wit:

> We turn first to the requirement that the payment be "on account of illness, disability, death, age, or length of service." *Ibid.* We have interpreted the phrase "on account of" elsewhere within the Bankruptcy Code to mean "because of," thereby requiring a causal connection between the term that the phrase "on account of" modifies and the factor specified in the statute at issue. In reaching that conclusion, we noted that "because of" was "certainly the usage meant for the phrase at other places in the [bankruptcy] statute," including the provision at issue here – § 522(d)(10)(E). *Ibid.* This meaning comports

> with the common understanding of "on account of." (citations omitted)

*Id.* at 1566.

Also interesting to note in *Rousey* and exactly on point with how the Respondents have indicated is the proper way to analyze a bankruptcy matter is how this very Court started its review of the *Rousey* bankruptcy matter. At the very beginning of its analysis of the case, this Court stated:

> As a general matter, upon the filing of a petition for bankruptcy '**all legal or equitable interest of the debtor in property**' become the property of the bankruptcy estate and will be distributed to the debtor's creditors. [11 U.S.C.] § 541 (a)(1).

(emphasis added).

This Court initially set forth what it considered part of the bankruptcy estate – property which the debtor has an interest using the definition as indicated in § 541 (a)(1).

It is not that the District Court and Third Circuit limited "property" in 11 U.S.C. § 506(b), as the Petitioner contends, rather the Petitioner seeks to expand "property" in 11 U.S.C. § 506(b) to a grossly illogical result to include other property regardless of whether the debtor has an interest in such property.

Contrary to the Petitioner's contention, there is no basis under 11 U.S.C. § 506(b) to expand the reach of the word "property" beyond the property in which the creditor and debtor's estate both have an interest.

With respect to the Petitioner's hypothetical situation, at page 15 of the Petition, of the corporate borrower and

the guarantor, the corporate debtor's petition would list the bank's claim at $1,000,000 of which $950,000 would be secured and $50,000 unsecured pursuant to § 506(a). The claim would not accrue interest pursuant to § 506(b). The guarantor debtor's petition would list a $1,000,000 bank claim and real estate of $950,000 securing the bank's claim. Likewise, this claim would not accrue interest pursuant to § 506(b).

If the two cases were substantively consolidated – which the DAK and DeNofas' cases were not – then the claim in both the corporate debtor and guarantor debtor cases would accrue interest and other charges as provided for in the contract and guarantee because there would then be one claim of $1,000,000 and property of the combined estates securing the claim of $1,900,000.

If the corporate asset was sold and $950,000 was realized, the $950,000 secured claim would be expunged and the $50,000 unsecured claim would remain in the corporate case. In the guarantor's case, the bank's secured claim would be reduced by $950,000. The remaining $50,000 would be secured by real estate of a value of $950,000 upon which the bank held a mortgage. Interest and other charges pursuant to the contract would then accrue pursuant to § 506(b) with respect to the $50,000 balance remaining unpaid.

Contrary to Petitioner's argument, there is nothing "absurd" about the above. Nor are lending problems posed by it. The Petitioner is entitled to no more than payment in full of the amount set forth in Continental Illinois' proof of claim without interest as the District Court correctly held.

## III. The District Court and the Third Circuit correctly held that NLI did not have the right to apply a payment made by a co-guarantor to the interest obligation of the co-guarantor, but rather the credit must go toward the principal obligation.

The Petitioner contends that the Katz's settlement payment of $250,000.00 should be applied to the interest obligation of the Katzes rather than the principal obligation of the loan debt of the DeNofas contending that "interest did continue to accrue post-petition on DAK's obligations and on Mr. Katz's Guaranty, even if interest did not accrue on Mr. DeNofa's Guaranty obligation". See Petition pages 15, 16 and 19. Further, the Petitioner contends that on this issue the Third Circuit's decision "**ignores critical facts** and, as a result, conflicts with settled principles of law." See Petition, page 16. (emphasis added).

From the outset, this factual issue should not be a basis to grant a petition for *writ of certiorari*, as stated Sup. Ct. R. 10, to wit; "A petition for a writ of certiorari is rarely granted when the asserted error consists of erroneous factual findings . . . "

As to the Petitioner's contention, the bankruptcy court fixed the Petitioner's claim at $323,615.69, after crediting payments made during the bankruptcy case, to wit; payments upon the liquidation of DAK and adequate protection payments received from Katz and DeNofas after the DeNofas' petition date. See Appendix D, page 23a-24a.

Here, there is only one claim, which is derived from one debt. All payments must be applied to it. To do otherwise

would be absurd as it would leave the DeNofas without any credit for payment by a co-debtor.

All of the adequate protection payments made by **Katz** were applied to the principal amount of the claim in fixing it at $323,615.69. See Appendix D, page 23a. This application has not been appealed as there is no question that such application is correct, as outlined in *In re Reddington/Sunarrow Ltd. Partnership*, 119 B.R. 809 (Bankr. D.N.M. 1990);

> If payments are made to an undersecured creditor, they must be allowed to reduce the allowed secured claim of the creditor. Otherwise the payments would be treated as interest payments or use value, in direct contravention of [*United Savings Association v. Timbers of Inwood Forest Assoc.*, 108 S.Ct. 626 (1988)] and Section 506.

*Id.* at 813.

The Katz $250,000 payment was and should be similarly treated. Since the Petitioner's claim does not accrue interest, all payments must be applied to the principal to reduce the claim. This is the holding of *In re Indian Palms Associates, Ltd.*, 61 F.3d 197 (3d Cir. 1995). In *Indian Palms*, a bank received adequate protection payments and rents in excess of expenses. The Court held that unless interest accrues on a debt during bankruptcy, there are no "theories that would support the allocation of post-petition payments to something other than a reduction of the principal debt." *Id.* at 211. There is no basis, as a matter of law, for the Petitioner to argue that the DeNofas' adequate protection payments can be applied to something other than the principal amount of Petitioner's claim. Likewise, there is no basis for the Petitioner to

argue that the Katz's $250,000 payment should not be applied to the principal of the Petitioner's claim. There is no distinction in the *Indian Palms* case concerning the source of the payments, which would justify a different treatment for the Katz $250,000 payment than the adequate protection payments made by the Katzs and DeNofas.

It is not disputed that there is only one "liability" – the loan to DAK. Thus, all payments received on account of the debt must be applied to the debt, which is the only liability. The right of the Petitioner to collect interest is a contractual right under the Guarantee which is modified by bankruptcy law in Section 506. The obligation to credit the amount due by payments from all sources is not modified and still enforceable here.

If payments are applied to something other than the principal amount of the claim, the Petitioner as a creditor would receive more on its claim than the value of its collateral, which is prohibited and not good policy. As there are other unsecured creditors of the DeNofas, the Petitioner would receive a higher percentage of its deficiency claim that is unsecured than other similarly situated unsecured creditors by not having to count the Katz payment, and still collecting the full value of their claim from the DeNofas.

This is what *Timbers* prevents in only awarding interest when the value of the collateral is more than the claim. Creditors like the Petitioner are protected from loss because as to Katz any recovery in the bankruptcy merely reduces his liability by an equal amount, and the Petitioner could always, in theory, recover its balance from Katz or anyone else jointly obligated not in bankruptcy.

That in this case the Petitioner jumped the gun and settled too quickly with Katz is its problem, and a matter between Katz and the Petitioner.

There is simply no authority for the Petitioner's position that it can ignore the Katz payment in computing its claim in this case. If the Petitioner were right, the DeNofas would have no benefit from Section 506 of the Bankruptcy Code. Most importantly, from a policy point of view, other creditors, who benefit from the § 506 bifurcation of claims because it preserves their pro rata distribution, would be prejudiced if a creditor could collect from co-obligors outside of bankruptcy, but not have to apply such payment against the co-obligor in bankruptcy.

## CONCLUSION

For all the foregoing reasons, the Respondents, respectfully urge this Court to deny the Petitioner's request for an issuance of a writ of certiorari to review a decision and order of the United States Court of Appeals for the Third Circuit entered February 17, 2005.

Respectfully submitted,

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